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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1958.

No. 529

ALABAMA BY-PRODUCTS CORPORATION,
Petitioner,

versus

GEORGE D. PATTERSON, District Director
of Internal Revenue,
Respondent.

PETITION FOR A WRIT OF CERTIORARI

To the United States Court of Appeals for the Fifth Circuit.

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To the United States Court of Appeals for the Fifth Circuit.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner prays for the issuance of a writ of certiorari to review a judgment of the United States Court of Appeals for the Fifth Circuit affirming the judgment of the United States District Court for the Southern Division of the Northern District of Alabama.

OPINIONS BELOW.

The opinion of the Court of Appeals is reported at 258 F. 2d 892 and is printed in the Appendix hereto. The opinion of the District Court is reported at 151 F. Supp. 641, but is not appended hereto because it appears at pages 432-453 of the record as printed for use of the Court

of Appeals, nine copies of which have been filed with this Petition, together with a certified copy of the record from the Court of Appeals.

JURISDICTION.

The date of the judgment or decree sought to be reviewed and the time of its entry is August 29, 1958.

The statutory provision believed to confer on this Court jurisdiction to review said judgment by writ of certiorari is Title 28, Section 1254 (1), United States Code (62 Stat. 928).

QUESTIONS PRESENTED.

The Court of Appeals says, in effect, that this is a case of first impression (Appendix 11). Accordingly, the essential primary questions presented, stated in abstract form, are:

1. What is the correct legal interpretation of the phrase "a mineral product of like kind and grade" as used in Section 39.23 (m)-1 (e) (3) of Treasury Regulations 118 (Appendix 22)?

2. What is the correct legal interpretation of the phrase "gross income from mining" as used in Section 114 (b) (4) (B), Internal Revenue Code of 1939 (Appendix 19), in cases of mining operations for recovery of natural resources (coals, ores and other minerals), not ordinarily sold or offered for sale by the owner, which operations are integrated, because of common ownership, with other operations, by the same owner, for the production of marketable end products?

3. Do the terms "gross income from mining" and "net income of the taxpayer (computed without allowance for depletion) from the property" mean income of the taxpayer

computed from its own books of account and resulting from sales of its own commercially marketable mineral products, or do those terms refer to some hypothetical income computed only with reference to the operations of other taxpayers whose costs and sales prices are not available to the taxpayer in the absence (in the matter of prices) of regularly published prices.

The instant case is typical of cases presenting the problem of correct computations of percentage depletion deductions in determining both "gross income from mining" and "net income of the taxpayer (computed without allowance for depletion) from the property" of all such integrated operations producing coke, iron, steel, and metal products of all kinds—a problem of national importance to all such integrated operations. It presents the specific questions expressed below in the terms and circumstances of the case sought to be reviewed. To put the questions in context, the following brief background is necessary:

This Petition involves a suit to recover income and excess profits taxes arising out of the right of Petitioner to deduct an allowance for percentage depletion on two types of coking coals mined by Petitioner and converted into high grade foundry coke and by-products. The allowance of such deduction depends upon the meaning to be given the phrase "mineral product of like kind and grade" contained in a Treasury Regulation providing for the computation of percentage depletion (Appendix 22); and the phrases "gross income from mining" and "net income of the taxpayer (computed without allowance for depletion) from the property" contained in the statute (Appendix 19). The Petitioner claims that such phrases require that differences in coking coals which have economic and commercial significance must be recognized by the Treasury Department in computing percentage depletion and that the taxpayer's own income from its own operations is the income which determines the deduction. The United States

laims that all coking coals which will make any commer-ially usable coke regardless of the kind or grade of coke roduced are of the same grade for purposes of computing ercentage depletion and the income to be used in com-uting the deduction is a hypothetical income based on ssumptions of fact with respect to a taxpayer's opera-ions that do not in fact exist and as to which a tax-ayer has no way of making the same assumptions. Peti-oner will be entitled to percentage depletion on part or of its coking coals (or other minerals) if any of the owing questions are answered in the negative:

1) In the case of a taxpayer with an integrated opera-on which involves the mining of its own coal, the proc-sing of that coal into the mineral products, coke and -products, in its own coke ovens, and the sale of such oke and by-products, instead of the unprocessed coal from hich the same are obtained, can it be held that such ke and by-products do not constitute the "commercially rketable mineral products" of which account must be ken in order to interpret any one or more of the phrases gross income from the property", "gross income from ining", and "net income **of the taxpayer** (computed ithout allowance for depletion) from the property" as ose terms are used in paragraphs (A) and (B) of sub-tion 114 (b) (4) of the 1939 Code? The Court of Ap-als in this case has rendered a decision on this question conflict with the decision of the Court of Appeals for First Circuit in **Dragon Cement Company v. United ates**, 244 F. 2d 513.

(2) May the District Court and the Court of Appeals, classifying and grading minerals (here coking coals) for rposes of computing percentage depletion, properly rely on the interpretation of the phrase "like kind" appear-in **Fleming v. Commissioner**, 241 F. 2d 78 (5th Cir. 7), when such case had already been reversed by this rt in **Commissioner v. Lake, Inc.**, 356 U. S. 260 (1958),

as the result of a more restricted and limited interpretation by this Court of the phrase "like kind"?

(3) Where both the District Court and the Court of Appeals have found as a fact that coking coals differ in volatile matter, ash content, fixed carbon, sulphur, phosphorous, porosity and carbon pick up qualities and that these distinctions cause different kinds of coke to be produced which, in turn, determine the ultimate nature of the product in the manufacture, treatment and processing of pig iron, steel and other minerals, can it be held that such critical factors shall be ignored by the Treasury Department in classifying and grading coking coals for the purpose of computing percentage depletion on coking coals merely because the Treasury Department may find it "difficult" to so classify and grade coking coals?

(4) Where both the District Court and the Court of Appeals have found as a fact that no blend of coking coals that did not contain the Petitioner's own Mary Lee coking coal could produce a foundry coke satisfactory for use in a malleable iron foundry, can it be held that the phrase "mineral product of like kind and grade" means that all other coking coals are of like kind and grade to Mary Lee coking coal as a matter of law on the grounds that the function which a particular coking coal will perform cannot be considered when classifying and grading coking coals for percentage depletion purposes?

(5) Where a taxpayer mines its own raw mineral products, converts them into commercially marketable mineral products in its own operations and sells such products on a nation-wide basis at a profit, can it be held, when interpreting a Treasury Regulation providing for the computation of percentage depletion on such taxpayer's mineral products, that the taxpayer did not realize any net income from its mining operations which are an indispensable part of that taxpayer's integrated operations which in fact produced substantial net income?

STATUTES AND TREASURY REGULATIONS INVOLVED.

This case involves Section 23 (m) (53 Stat. 1), and Section 114 (b) (4) (53 Stat. 1, as amended by 53 Stat. 45, 56 Stat. 840, 58 Stat. 44, 45, 61 Stat. 920, 64 Stat. 131, 64 Stat. 1220, 65 Stat. 497), of the Internal Revenue Code of 1939 (26 U. S. C. 1952 ed., Section 23 and 114) and United States Treasury Regulations 118, Sections 39.23 (m)-1, (e), (f), (g), (h) and (i); all of which are set out at pages 17 to 26 of the Appendix.

STATEMENT OF THE CASE.

The Court of Appeals has erred in some of the facts stated in its opinion in that some of its statements are not supported by the record. These errors are a matter to be brought to this Court's attention if this Court agrees with us that the questions presented warrant the grant of a writ of certiorari. Somehow, or other the Treasury and both Courts below seem to have thought that because all bituminous coal is black and will burn it is of "like kind." Nothing could be further from the fact.

The Court of Appeals has put too broad an interpretation on the words "like kind", just as it did in its own decision in **Fleming v. Commissioner**, supra (reversed by **Commissioner v. Lake, Inc.**, supra), and *a fortiori*, entirely too broad an interpretation on the words "like grade." To say all coking coal is of like grade is clearly erroneous when the Court of Appeals itself says there are distinctions in coking coals which "will cause different kinds of coke to be produced when the coal is heated, which, in turn, determines **to a large extent** the nature of the end product in the manufacture of steel and pig iron" (Appendix 9). If these distinctions determine **"to a large extent"** the nature of the end product, how can the Court of Appeals in the next

paragraph of its opinion say that these distinctions are without "commercial substance" (Appendix 9).

The Petitioner claims that it will be entitled to recover approximately $621,807 of income and excess profits taxes for the year 1952 if the Petitioner is allowed a deduction for percentage depletion on certain coking coals mined by it and converted into foundry coke and by-products (R. 12-15). The Petitioner filed a claim for refund to recover such taxes, the claim was denied, and thereupon Petitioner filed suit in the United States District Court under Section 1291, Title 28, U. S. C., for recovery of the refund claimed—the basis for federal jurisdiction in said District Court.

Petitioner is and long has been engaged in the business of mining coking coals, converting them into two grades of foundry coke and by-products and selling such coke and by-products principally to foundries on a nation-wide basis (R. 434, 435). The Petitioner made certain incidental sales of coking coals in the year in question which neither of the courts below apparently have considered significant as determining a market price because of the unusual circumstances under which such sales were made (Appendix 13). Petitioner's plant and coal mines are located in and around Birmingham, Alabama, substantially all in Jefferson County in that State (R. 434).

Under Section 114 (b) (4) of the Internal Revenue Code of 1939, the Petitioner is entitled to a deduction for percentage depletion on its coking coals at the rate of 10% of gross income from mining but limited to an amount not exceeding 50% of the "**net income of the taxpayer** (computed without allowance for depletion) from mining." Petitioner is entitled to an allowance for percentage depletion on its coking coals because it has in fact mined its coking coals at a profit.

A coking coal is a bituminous coal which has the necessary physical and chemical properties required to produce coke (R. 435). The District Court and the Court of Appeals

found that commercially usable coking coals differ in volatile matter, ash content, carbon pick up, sulphur content, porosity and phosphorous content, and that such differences affect the kinds of coke produced and the use to which coke can be put (R. 438, 439, Appendix 8 and 9). Despite this specific finding of fact, the District Court and the Court of Appeals held that all bituminous coals mined in the Birmingham, Alabama, district were "mineral products" of "like kind" and that all coking coals suitable for commercial use were "mineral products" of "like grade";—in other words, that because the coal would coke it was of like grade regardless of the kind of coke it would produce.

Accepting the Respondent's contention that all commercially usable coking coals are of the same grade, the District Court and Court of Appeals held that there were substantial sales of commercially usable coking coals in the year in question and, accordingly, that there were in existence representative market prices of coking coals of like kind and grade which established the Petitioner's gross income and net income from mining (R. 451, Appendix 13) and this even though there were no published prices available to the taxpayer at the time it filed its returns from which the necessary calculation of a representative market or field price could be obtained, and there had not been any such published prices for ten to twelve years prior to 1952 (R. 164). These prices were such that the Courts below considered Petitioner to have mined its coking coals at a loss and, therefore, that it was not entitled to any percentage depletion thereon. If the Petitioner's gross income and net income from mining coking coals are determined on the basis of the proportionate profits method the total net income from mining coking coals for the year in question is $2,177,813 (R. 312), fifty per cent of which exceeds the percentage depletion deduction claimed by Petitioner. The allowance of percentage depletion accordingly depends upon the method to be used

to determine Petitioner's "gross income from mining" and "net income of the taxpayer from the property". The proportionate profits method permits a computation from facts readily available to any taxpayer from its own books and records. "Under the proportionate profits method, if a taxpayer's mining costs amount, say to 40 per cent of the total costs of all operations involved in obtaining the taxpayer's commercially marketable mineral product, then 40 per cent of the total gross sales constitute gross income from mining" (Appendix 2, Note 1).

Accordingly, among the specific questions of law which this Court is asked to review is the meaning of the phrase "a mineral product of like kind and grade" as used in Treasury Regulations 118, Sec. 39.23 (m)-1 (e) (3) (Appendix 22), and the meaning of the phrase "gross income from mining" under Section 114 (b) (4) (B) of the 1939 Code (Appendix 19).

REASONS FOR GRANTING THE WRIT.

1. The decision of the Court of Appeals in this case is in conflict with the decision of the Court of Appeals for the First Circuit in Dragon Cement Company v. United States, 244 F. 2d 513, and with the decisions of other Courts of Appeal, and this conflict should be resolved by this Court.

In **Dragon Cement Company v. United States**, 244 F. 2d 513 (1st Cir., 1957), cert. den. 355 U. S. 833, the taxpayer quarried calcium carbonate (a type of limestone commonly called "cement rock") and converted it into cement which it sold. The taxpayer claimed and the First Circuit held that under Section 114 (b) (4) (A) of the 1939 Code the commercially marketable mineral product upon which the taxpayer was entitled to compute its depletion was cement. The First Circuit reached this conclusion because cement was a marketable mineral product produced by the taxpayer and permitted the taxpayer to compute its percentage depletion on calcium carbonate based upon the sale

of the cement produced therefrom. The taxpayer was not required to take account of the price it might have received if it had sold its cement rock for use as a concrete aggregate or for ballast or road building purposes which would have been a commercially non-profitable use for that taxpayer.

The Petitioner in the instant case claims that under Section 114 (b) (4) it is entitled to compute its gross income from mining based upon a proportionate part of its gross sales of coke and by-products, because these were the marketable mineral products produced by Petitioner. The Fifth Circuit has held that the Petitioner must compute its gross income from mining coal using market prices established by sales of coking coals by other coal producers. The Fifth Circuit has refused to permit Petitioner to compute gross income from mining from sales of its own products, whereas the First Circuit reached the opposite result in **Dragon Cement**. Dragon Cement Company's gross income from mining was ascertained by reference to the ultimate end use to which the crude mineral product, calcium carbonate, was put, namely, the production of cement. In the instant case the Fifth Circuit refuses even to consider the end use to which Petitioner's coals have been put. In these respects the decision of the First Circuit in the **Dragon Cement** case is clearly in conflict with the decision in the Fifth Circuit in this case.

Dragon Cement, supra, cites **Townsend v. Hitchcock Corporation**, 232 F. 2d 444 (1956), by the Fourth Circuit, **United States v. Sapulpa Brick & Tile Corp.**, 239 F. 2d 694 (1956) by the Tenth Circuit, and **United States v. Cherokee Brick & Tile Company**, 218 F. 2d 424 (1955), by the Fifth Circuit, all of which decisions are based on a rationale in conflict with the Court of Appeals' opinion in the instant case.

Furthermore, this same Court of Appeals for the Fifth Circuit again used the same rationale in **United States v. Merry Brothers Brick & Tile Company**, 242 F. 2d 708 (1957), with respect to which certiorari was denied, 355 U. S. 824, concurrently with the denial of certiorari in **Dragon Cement**, supra, although in the instant case the Court of Appeals ignores the conflict which it has created with its own decisions.

Dragon Cement, supra and **Townsend**, supra, both hold that the ordinary treatment processes named in the statute were not all inclusive so that the attempt to limit the taxpayer's treatment of percentage depletion named in the statute, which appears in Treasury Regulations 118, Section 39.23 (m)-1 (e) (3) (Appendix 42), is and was, when the Court of Appeals decided the instant case, clearly without legal effect. If the decision of the Court of Appeals in the instant case forecloses the question, it is also in conflict with the decision of the Tax Court in **Iowa Limestone Company v. Commissioner of Internal Revenue**, 28 T. C. 881 (cited by the Court of Appeals, Appendix 30); **Dixie Lime Products Company v. United States**, 57-2 USTC 9933 (1957), decided by the District Court for the Southern Division of Florida; **Wagner Quarries Company v. United States**, 154 F. Supp. 955 (1957), decided by the District Court for the Northern District of Ohio, and the very recent decision in **Monolith Portland Cement Company v. United States**, 58-1 USTC 68,248, 1 A. F. T. R. 2d 1512 (1958), decided by the District Court for the Southern District of California, where a correct interpretation of the term "like-kind and grade" as applied to calcium carbonates or magnesium carbonates, or a combination of both, required classification as either chemical **grade** limestone or metallurgical **grade** limestone. To the same effect was **Riverton Lime & Stone Company v. Commissioner of Internal Revenue**, 28 T. C. 446 (1957), decided on the same rationale as the **Dragon Cement** case, supra, and in which

"hydrated hydraulic lime" was necessarily distinguished from other grades of calcium carbonates.

2. **The Court of Appeals has here decided a federal question in a way in conflict with an applicable decision of the Supreme Court.**

The Court of Appeals has cited, as a basis for its conclusions here, its own interpretation of the phrase "like kind" appearing in **Fleming v. Commissioner,** supra, and its own related cases (Appendix 11), when that case has been reversed by this Court in **Commissioner v. Lake, Inc.,** supra, as the result of a more restricted and limited interpretation of the phrase "like kind" by this Court. The **Fleming** case involved the question of whether the exchange of an oil payment for an interest in real property was a non-taxable exchange of property of "like kind". The Court of Appeals had held that it was and this Court reversed on the grounds that it was not an exchange of property of "like kind". The Court of Appeals has disregarded this Court's interpretation of "like kind" in **Lake, Inc.,** by assigning too broad a meaning to such phrase. Moreover, the Court of Appeals has, in effect, interpreted the phrase "mineral product of like kind and grade" in the instant case as though "grade" means the same thing as "kind", although "grade" requires an even narrower field of operation than "kind".

3. **The Court of Appeals has here decided important questions of federal law which have not been, but should be, settled by this Court.**

The method of computing percentage depletion and, accordingly, a correct legal interpretation of "like kind and grade" as used in the Treasury Regulations, and "gross income from mining" and "net income of the taxpayer (computed without allowance for depletion) from mining", as used in the Internal Revenue Code, are of nation-wide and current importance and are essential to enable all inte-

grated operators, which mine their own raw minerals and themselves use them in the production of their commercially marketable mineral products, instead of offering such raw minerals for sale in the markets, to know their tax liabilities. Its importance is graphically illustrated in the case of integrated producers of steel, pig iron and coke which mine their own coking coals and convert them into furnace coke for the manufacture of pig iron and steel or foundry coke for melting iron and other metals. In 1952 eighty-two per cent (82%) of the total production of oven coke in the United States was produced by integrated iron and steel companies.[1]

The Court of Appeals has stated in its opinion (Appendix 11) that it was unable to find any case interpreting the phrase "mineral products of like kind and grade" or the phrase "like grade" as used in this particular Treasury Regulation. This case is, accordingly, one of first impression and presents a question of federal law which should be, but has not been, decided by this Court.

4. The Court of Appeals has here so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

The Court of Appeals seems to have rejected the Petitioner's interpretation of the Treasury Regulation as being "unworkable" and "difficult" to administer—indeed a strange position when volumes of tax decisions by many courts have proven necessary for correct interpretation of the multitude of ambiguous phrases used in the Internal Revenue Laws since 1913, and in the diverse Treasury Regulations issued thereunder. The Court of Appeals says (Appendix 13) "To go further and classify coking coals according to their myriad of actual uses would lead to an

[1] Mineral Yearbook, 1952, Vol. II, page 192, prepared by Bureau of Mines, United States Department of the Interior.

unworkable system of grading coal, since the requirements of coke users vary greatly." And again (Appendix 15), "The Commissioner would have a difficult, if not impossible, task." However, it does not consider the difficulty confronting the taxpayer in finding out, within the short time following the close of a taxable year within which its income tax returns must be filed, which of a number of a multitude of prices for different classes of coking coals shall be used to arrive at a hypothetical representative market price when no such figure or group of figures is available to the taxpayer as a matter of right. If the Court of Appeals' decision is to stand, it is obvious that the unworkable and difficult position is the position of the taxpayer and not the position of the Internal Revenue Service. And the taxpayer's only remedy has been resort to the courts for common sense interpretations of the law and the Treasury Regulations.

The Court of Appeals in agreeing with the Internal Revenue Service in this case has arbitrarily denied this Petitioner and all others similarly situated a legal deduction for percentage depletion and placed them in an impossible position with respect to filing any income tax returns for the year in question or any year before or subsequent to 1952.

ARGUMENT.

All coal is black and will burn. Anthracite coal, lignite and some other coal fuels, although black and burnable, are not otherwise even similar to bituminous coal. Even bituminous coal, with little or no coking properties, useful principally to produce steam and heat for various purposes, is not even similar to bituminous **coking** coal. However the Treasury, the District Court and the Court of Appeals all start on the erroneous premise that all bituminous coal is coal of like kind, and that bituminous coking coal and bituminous non-coking coal are the two grades thereof (a mistaken premise which can vitally affect the legal rights of all integrated mine owners). The Treasury, the District Court and the Court of Appeals all use an "end use test" to distinguish between "kind" and "grade" though specifically rejecting any so-called "end use test" for grading coking coals and other minerals.

The interpretation of the phrase "like kind and grade" which the Court of Appeals states is **"crucial"** (Appendix 11) must start with the fact that "kind" and "grade" are used in the conjunctive and must necessarily require proper separate interpretations of "like kind" and of "like grade", words with two entirely different meanings —they do not mean the same thing.

"Grade" certainly has a common sense, ordinary meaning. So tobacco, cotton, lumber, coffee, tea, oil, indeed almost every so-called "raw" commodity has various grades. Interpretation should be realistic, not narrow. The taxpayer is entitled to "reasonable" interpretation —here a "reasonable allowance" for depletion of its prime natural resources. And what is said here applies equally as to "grades" of all minerals.

In Volume 1, Webster's New Twentieth Century Dictionary, Unabridged, Second Edition, "grade" is defined, among other definitions, as follows:

"any of the stages in an orderly, systematic progression; step; degree;

"a degree in a scale classifying according to quality, rank, worth, etc.; as, these eggs are **grade** A;

"to arrange in degrees, ranks, classes, or steps, according to order, series, quality, size, etc."

In the **Dragon Cement** and **Riverton** cases, supra, the crucial question was whether "cement rock" and "pure lime" were "commercially marketable mineral products". Both were calcium carbonates (I. R. C. 1939—Sec. 114 (b) (A) (ii), Appendix 18) in form of stone used for a multitude of purposes. In each decision the stone is graded according to end use, though equally useful for ballast, grading and a multitude of other purposes for which sold in the markets at varying prices. The Courts in these cases applied the statutes and not the Treasury Department's impractical and **"unworkable"** regulations.

The Court of Appeals in its opinion makes a strange statement, viz., "Alabama By-Products does not, however, blend its coals" (Appendix 10). On the contrary, the whole record is clear that all Alabama foundry cokes are produced by blending; in the case of this Petitioner, blending of its Mary Lee seam and Black Creek seam coals, together with a small tonnage of West Virginia coals. Blending in and of itself necessarily requires the use of different grades of raw material (R. 77-9, 83-5, 162, 330, 435-6, 440-2, 444 and 446). This error perhaps influenced the erroneous conclusion of the Court of Appeals that differences in physical and chemical characteristics of coking coal were not of commercial substance.

Briefly, the opinion of the Court of Appeals in this typical case is in error primarily in what has just been said and in many other respects, among others the following:

(1) In ignoring the plain provision of the statute (I. R. C. 1939—Sec. 114 (b) (4) (A) and (B); Appendix 18) that "the **taxpayer's** net income (computed without allowance for depletion) from the property" measured by its gross income obtained from sale of its commercially marketable mineral product is the test, not some hypothetical income.

(2) In ignoring its resulting conflict with the **Dragon Cement** case, supra, and decisions therein relied on and in effect disregarding the rationale of its own decisions (Appendix 14).

(3) In ignoring the undisputed testimony that blast furnace coke (used to reduce iron ore to pig iron in a blast furnace) and foundry coke (used to heat or melt metal in a foundry cupola) are entirely different (R. 434-5).

(4) In overlooking the undisputed testimony that coking coal which contains too much sulphur and, accordingly, a **grade** different from other Alabama coking coals, cannot be used alone or in a blend to produce foundry coke, although it can be used to produce furnace coke (R. 438) (Appendix 10).

(5) In ignoring the undisputed testimony that no Alabama coking coals could produce a foundry coke suitable for use in a malleable iron foundry unless Petitioner's Mary Lee seam low carbon pick up coal was used in the blend, and that such low carbon pick up coal is a grade different from other Alabama coking coals (R. 450) (Appendix 10).

(6) In assuming that the wide variation in prices of Alabama coking coals in the open market in 1952, viz., from slightly over $4.00 per ton for unwashed coal bought by Republic Steel, up to nearly $10.00 per ton for blacksmith coal produced from Petitioner's Black Creek seam, and even higher delivered prices paid by the only three

roducers of foundry coke (Petitioner, United and Foundry Company, and DeBardeleben Coal for West Virginia coking coals, did not in and dicate differences in **grades** of these coals (R.).

ating that difficulty which might be encountered asury in applying its own regulations to grad- ous coking coals according to differences which rcially recognized and have an economic sig- should deny taxpayers a deduction to which early entitled[2] (Appendix 15). If the regula- ult in administration, that difficulty was created sury Department itself by the use of the ex- se kind and grade" in the regulations in dis- he plain provisions of the statute. This Court he natural meaning of words cannot be dis- reference to difficulties in administration". s adopted by this Court in **Addison v. Holly roducts**, 322 U. S. 607 at 617.

iling to recognize that commercially significant r. grades of coking coals must necessarily exist rent grades are necessary to produce different d in stating that the so-called "end use test" lly disregarded in arriving at a correct defini- **grade"** in spite of the fact that the use to duct is put necessarily determines its value d that when, as here, blends of commercially ng coals are required to produce a desired sult must be considered in grading the coal endix 10).

Regulations proposed to be issued under Section 613 ternal Revenue Code (relating to percentage deple- products) the Commissioner proposes to assume the ng adjustments to market prices for mineral products imilar in kind and grade. Proposed Regulations, Sec- rentice-Hall Fed. Tax Ser., Internal Revenue Code 24, 618.13-14.

(9) In stating that the Petitioner operated its coal mines at a loss, regardless of the fact that in operating the mines and in producing the coal from which about 20% of all foundry coke marketed in the United States in 1952 was processed (R. 435), the Petitioner realized a substantial profit in the sale of the two grades or types of foundry coke produced primarily from its own coking coals, all of which profit was attributed by the Court of Appeals only to processes beyond mining. It is clear that coking is an ordinary treatment process for the production of coke and the by-products of coal, and that they are both commercially marketable mineral products, the inherent ingredients of which are obtained from the types of coal which the Petitioner mined. It is also obvious that in integrated operations, such as are in issue, each dollar of cost earns its pro rata share of the total profit from the integrated operation. All of the coke ovens in Alabama were and are operated as a part of an integrated operation and, accordingly, the demand for coking coals produced by independent mining companies was relatively limited.[3] If the available reserves of Alabama coking coals were owned by independent commercial coal mining companies which mined such coking coal and sold it to the coke, pig iron and steel companies for use by them in their coke, pig iron and steel operations, the prices at which the coking coal would be sold would be at prices allowing the coal mining companies a reasonable profit.

(10) In stating that "the proportionate profits method provided by the regulations was not intended to assure percentage depletion to a taxpayer who conducted its mining operations at a loss" (Appendix 15)—that statement obviously begs the question in cases such as this because the issue before the Court was whether or not the Petitioner, in fact, conducted its mining operations at a loss,

[3] DeBardeleben's operation was only partially integrated in its use of its own coal from its Empire mine.

and the Court of Appeals assumed the answer when it made that incorrect statement. The proportionate profits method used by the Petitioner in its claim is a rational and logical method for determining whether or not a taxpayer conducts its mining operations at a profit. The Court of Appeals has given no recognition to the particular grades and qualities of the Petitioner's coking coals which enabled it to realize a substantial profit from its integrated operation when it relied upon sales of coking coal by others which were in nowise comparable in grade and quality to Petitioner's coking coal.

While the foregoing argument is addressed primarily to the facts in this particular typical case, with variations to fit the facts in other cases it is applicable and of the utmost importance to all such integrated operations of which, as a matter of common knowledge, there are many, viz., producers of furnace and foundry cokes, pig iron, steel, copper and metals of all kinds.

Summarizing, the Court of Appeals in this case has published an opinion in direct conflict with decisions in other circuits and indeed with its own decisions in depletion cases. It has entirely disregarded the provisions of I. R. C. 1939—Sec. 114 (b) (4) (A) and (B) (Appendix 18) in its interpretation of "net income of the taxpayer (computed without allowance for depletion) from the property," "gross income from mining" and "commercially marketable mineral product or products", all of vital importance to enable taxpayers engaged in the extraction of minerals enumerated in the statute to ascertain income tax liabilities. Further, the Court of Appeals recognized that the interpretation of the phrase "like kind and grade" is **"crucial"** in determination of this case of first impression. It said "Counsel have cited no cases on brief that interpret the crucial phrase. We have been unable to find any." (Appendix 11). It follows this statement by using its own decisions, culminating in the **Fleming** case, supra, which has been re-

versed by this Court, to interpret "like kind." Then the Court of Appeals proceeds to an interpretation of "like grade" which it says "has not been interpreted" (Appendix 11), ignores the generally accepted meaning of "grade" when applied to raw materials of all kinds, says the use to which different grades of raw materials are put is of no importance and finally begs the question by saying that the integrated operation here produced no "net income from mining" but that substantial net income from integrated operations such as Petitioner's must all be assumed to have resulted from processes after mining.

This Petitioner's position can be very briefly put: When the integrated operation results in a profit, there can be no application or construction of the statute or of the Treasury Regulations or of any term in either which would justify the conclusion that the mining part of the integrated operation resulted in a loss.

The error of interpretation by the Court of Appeals of phrases used in the Treasury Department Regulations lies in the assumption that all bituminous coal is of like kind, whereas if the **Lake** case, supra, reversing **Fleming**, supra, is to be given any effect bituminous coal that will produce coke and bituminous coal that is unfit for coke production are as different as a fee title interest in real estate and interests in real estate limited to oil payment assignments—**Commissioner v. Lake, Inc.**, supra. The grades of coking coals are substantially different—some cannot even be used to produce foundry coke; of Alabama coking coals only one, Petitioner's Mary Lee seam coking coal, can be used in a blend to produce coke for melting iron in a malleable iron foundry, and only by blending of various grades of Alabama coking coals can merchantable foundry coke be produced at all.

The same grading must, as a matter of common knowledge, be applicable to all minerals of like kind, as for

instance, low grade, intermediate grades and high grades of metallic ores. The erroneous interpretations applied by the Court of Appeals badly need correction by this Court.

CONCLUSION.

The District Court and the Court of Appeals committed clear errors of law, the correction of which by this Court is essential to the fair and impartial administration of the revenue laws. It is respectfully submitted that the writ should be granted.

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Certificate of Service.

I certify that I have served the within Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit pursuant to the terms of paragraphs 1 and 2 of Rule 33 of the Revised Rules of the Supreme Court of the United States by depositing a copy thereof in a United States post office with air mail postage prepaid and a confirmation with the first class postage prepaid and addressed to the Solicitor General, Department of Justice, Washing-

ton 25, D. C., by serving a copy thereof on W. L. Longshore, one of the attorneys for the Respondent herein, United States Attorney, Post Office Building, Birmingham, Alabama, and by depositing a copy thereof in the United States Post Office with air mail postage prepaid, and a confirmation with first class postage prepaid addressed to Charles K. Rice, Department of Justice, Washington 25, D. C., the other attorney for Respondent herein.

This 19 day of November, 1958.

William B. White

William B. White,
Attorney for Petitioner.

APPENDIX.

In the
UNITED STATES COURT OF APPEALS
For the Fifth Circuit

No. 16840

Alabama By-Products Corporation,
Appellant,
versus
George D. Patterson, District Director of
Internal Revenue,
Appellee.

Appeal from the United States District Court for the Northern District of Alabama.

(August 29, 1958.)

Before Hutcheson, Chief Judge, and Brown, and Wisdom, Circuit Judges.

Wisdom, Circuit Judge: Alabama By-Products Corporation filed suit to recover income and excess profit taxes for 1952. Recovery depends on the right of this taxpayer to an allowance for percentage depletion on certain coking coal mined by the taxpayer and converted into foundry coke in its by-product coke-ovens.

Section 23 (m) of the 1939 Internal Revenue Code provides for "a reasonable allowance for depletion" on mines. Section 114 (b) (4) of the 1939 Code allows percentage

depletion on coal at the rate of 10 per cent of "gross income from mining" coal, such allowance not to exceed 50 per cent of the "net income from mining" coal. Section 39.23 (m)-1 (e) (3) of Treasury Regulations 118 allows a taxpayer to use the proportionate profits method[1] of computing "gross income from the property" for purposes of determining percentage depletion. This method may be used, however, only if there is no "representative market or field price of [coal] of like kind and grade". The case, therefore, narrows down to the question, did the taxpayer, Alabama By-Products Corporation, discharge its burden of proving by a fair preponderance of the evidence that there was in the Birmingham area no "representative market or field price of [coal] of like kind and grade" to its Mary Lee and Black Creek coking coal mined by it in 1952?

The case was tried without a jury. The district court held that the taxpayer had failed to discharge its burden: all bituminous coal mined and marketed in the Birmingham area, having coking properties for commercial usage, is coal of "like kind and grade" to the taxpayer's Mary Lee and Black Creek coal. We agree.

I.

Alabama By-Products Corporation, the taxpayer, 1952, and prior thereto, was engaged in the business of mining and selling coal, manufacturing coke, and selling coke and coal by-products. In 1952 the company mined coal from the Mary Lee and Black Creek seams of the Warrior coal field in Alabama. The Warrior field is one of four bituminous coal fields in the state.

[1] Under the proportionate profits method, if a taxpayer's mining costs amount, say, to 40 per cent of the total costs of all operations, then 40 per cent of the total gross sales constitute gross income from mining.

With respect to the Mary Lee seam, taxpayer operated mines at Praco, Colta, and Labuco. All of this coal was cleaned, broken, sized, and loaded for shipment at a preparation plant located at the Praco mine. Coal from the Black Creek seam was extracted from mines located at Bradford and Thermal. This coal was also cleaned, broken, sized, and loaded for shipment by the taxpayer at preparation plants located at the respective mines.

Most of the coal the taxpayer mined was utilized at its own coke ovens in the manufacture of coke to make grey iron foundry coke and malleable iron foundry coke. Some coal was sold to others in the mining area. The taxpayer purchased some coking coal from other mining companies as well. Furthermore, there were extensive sales of coking coal mined from the three other bituminous coal fields by other mining companies, as well as from the Warrior field.

After the Mary Lee coking coal was prepared at the plant at Praco, Alabama By-Products sold 86,690 tons to purchasers at prices ranging from $5.05 to $7.93 per ton. 44,691 tons of the Mary Lee coking coal were sold to a competitor, DeBardeleben Coal Corporation, at prices ranging from $6.30 to $6.89 per ton. DeBardeleben's coke was sold on the same market as that of the taxpayer, and the prices received by DeBardeleben for such coke were substantially the same as those received by taxpayer. Some of their customers were the same. In addition to purchasing from the taxpayer, DeBardeleben purchased other coking coal from the Black Diamond Coal Mining Company, the Twin Seam Mining Company, and coal mined from the Blue Creek seam in Jefferson County, Alabama. DeBardeleben blended all of these coking coals in the manufacture of its coke.

Republic Steel Corporation also made extensive purchases of Mary Lee coking coal. Some of these purchases

were from taxpayer, some were from other vendors. In addition, coal for Republic's coke manufacturing was also purchased from the Pratt and Brookwood seams. The T. C. I. Division of United States Steel Corporation and United States Pipe and Foundry Company also purchased Alabama coking coals during 1952.

As to the Black Creek seam, Alabama By-Products purchased 84,402 tons from Calvert and Youngblood, and 8,850 tons from small truck miners near the Bradford mine at prices ranging from $5.50 to $6.50 per ton. The taxpayer did not sell any Black Creek coal for use in the manufacture of coke by others in 1952; however, some of this coal was sold for use as blacksmith coal at prices ranging from $9.31 to $10.65 per ton. The taxpayer also made some sales to its employees pursuant to union contracts. All of the washed Black Creek coal produced by Dixie Fire Brick Company was purchased by taxpayer at $6.50 per ton.

There were also a number of sales agencies in Birmingham engaged in selling coking coal. One sales agency alone, the Smith Coal Sales Company, sold 371,655 tons of coal in 1952. Of this tonnage, 221,697 tons were coking coals, and of that amount, 98,416 tons were sold for coking purposes. Taxpayer's own sales were made at prices below its average cost of production, but there is no showing that sales by other companies were made under such circumstances.

Turning now to the taxpayer's tax liabilities, the taxpayer reported a gross income of $6,233,080.10 and a net income of $4,555,457.81 in 1952. In computing net income, Alabama By-Products deducted $21,962.04 for depletion of mineral resources; of this amount, $20,729.50 was for the cost depletion of coal. In determining its depletion allowance for coal, *the taxpayer used a representative market or field price based on sales made*, and computed a percentage depletion deduction. Mining operations were con-

ducted at a loss in 1952. As a result, there was no net income, and the taxpayer could not take the percentage depletion deduction, since it is limited to 50 per cent of net income from mining under Section 114 (b) (2) of the Internal Revenue Code of 1939. The taxpayer was allowed to take cost depletion in the amount of $20,729.50.

Based upon the foregoing computations, Alabama By-Products paid income and excess profits taxes for 1952 in the amount of $2,708,371.59. January 18, 1954, the taxpayer filed a claim for refund with the District Director in the amount of $588,586.97. On February 12, 1956, the District Director assessed additional income taxes, and interest thereon, in the amount of $2,068.18, which were paid. February 23, 1956, the taxpayer filed an amended claim for refund, in substitution for the earlier claim, in the amount of $590,353.16. The claims for refund were based on the taxpayer's revised computation of gross and net income for 1952; on the ground that there was no representative market or field price for coal of like kind and grade, and that Alabama By-Products was therefore entitled to use the proportionate profits method to determine gross and net income from mining in computing its percentage depletion deduction.

These claims were disallowed by the District Director and the taxpayer sued for a refund on March 9, 1956. The original complaint stated that there was no representative market or field price of a coal of like kind and grade. On February 11, 1957, the taxpayer filed an amended complaint stating, in the alternative, that if there was a representative market price for its coal, then its net income from mining was improperly computed because overhead and other costs had been improperly allocated to mining operations. On April 2, 1957, after the trial of the case the taxpayer attempted to amend the complaint a second time. This second amendment stated, in the alternative,

that if the taxpayer had not carried the burden of proving that there was no representative market or field price, then such price, if it existed, was greater than that originally used in computing the percentage depletion.

The District Court concluded that Alabama By-Products had failed to show that in the Birmingham area there was no representative market or field price for coal of like kind and grade. The taxpayer was not, therefore, entitled to use the proportionate profits method. As to the amended claims, the court said that they were not raised by the original claim for refund and could not be raised at the trial.

II.

Section 23 (m) of the Internal Revenue Code of 1939 provides an allowance for depletion, which, in the case of coal, is equal to the cost of the property depleted or its discovery value.[2] If percentage depletion is utilized Section 114 (b) (4) (A) provides that the allowance is equal to 10 per cent of the "gross income property" during the taxable year. Section 114 (b) (4) (A) also provides that in no case can the percentage depletion allowance exceed 50 per cent of the net income of the taxpayer from the property. "Gross income from the property" is defined by the statute to mean "gross income from mining", and "mining" is defined as including the ordinary treatment processes normally applied in order to obtain a commer-

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[2] Internal Revenue Code of 1939:

Sec. 23. Deductions From Gross Income.

In computing net income there shall be allowed as deductions:

* * * * * * * * *

(m) Depletion.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *"

cially marketable mineral product, after the mineral has been extracted from the ground.[3]

Section 39.23 (m)-1 (e) (3) of Treasury Regulations 118 provides that, if, as here, the mineral product is processed before sale by processes in addition to the ordinary treatment processes, then "gross income from the property" means the representative market or field price as of the date of sale of a mineral product (in this case, coal) of "like kind and grade" at the ordinary treatment processing stage. If there is no representative market or field price, then the so-called proportionate profits method of computing income may be used.[4]

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[3] Section 114 (b) (4) (B) provides:

"As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining" as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills. The term "ordinary treatment processes," as used herein, shall include the following: (i) in the case of coal-cleaning, breaking, sizing, and loading for shipment; . . ."

[4] "Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939:

Sec. 39.23 (m)-1 [as amended by T. D. 6096, 1954-2 Cum. Bull. 69]. Depletion of mines, oil and gas wells, other natural deposits and timber; depreciation of improvements.

* * * * * * *

(e) As used in sections 114 (b) (3) and 114 (b) (4) (A) and §§ 39.23 (m)-1 to 39.23 (m)-19, inclusive, the term "gross income from the property" means the following:

. . . . . .

(3) If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, "gross income from the

ama By-Products contends that the phrase "mineral
t of like kind and grade" as used in Section 39.23
(e) (3) refers to mineral products with the same in-
attributes and characteristics as the depletable min-
question. The taxpayer points to the many physical
mical properties that distinguish kinds of coking
Coking coals differ as to volatile matter, ash con-

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means the amount for which such product was sold, but,
duct is transported or processed (other than by the ordi-
ment processes described below) before sale, "gross in-
the property" means the representative market or field
of the date of sale) of a mineral product of like kind and
beneficiated by the ordinary treatment processes actually
fore transportation of such product (other than transpor-
ed, for the taxable year, as mining). If there is no such
ive market or field price (as of the date of sale), then
be used in lieu thereof the representative market or field
e first marketable product resulting from any process or
(or, if the product in its crude mineral state is merely
d, the price for which sold) minus the costs and propor-
ofits attributable to the transportation (other than trans-
treated, for the taxable year, as mining) and the processes
e ordinary treatment processes. If the taxpayer estab-
the satisfaction of the Commissioner that another method
tation, other than the computation of profits proportionate
clearly reflects the gross income from the property, then
income shall be computed by the use of such other

is manufactured by placing d bituminous coking coal
sizes 1" x 0" or smaller in a c sed retort and applying
coking coal under the influence o heat, first softens and
higher temperature becomes fluid; at a still higher
re the coal decomposes with accompanying evolution of
at a still higher temperature the gas is driven off and the
s in the coking coal, acting as an agglutinating agent,
emaining materials together to form a cellular structure
A satisfactory coking coal must have sufficient bi-
to bind the other components of the coal together. The
ng characteristics or bitumen content of coking coals
ly among different coals. A non-coking coal has either
o few bitumens to give the coal agglutinating properties
coal will not form a satisfactory coke.
ition to containing the necessary agglutinating or coking
a coking coal must have the proper amounts of fixed
volatile matter to make a commercially usable coke and
w in ash and sulphur to produce foundry coke. A

tent, carbon pickup, sulphur content, porosity, and phosphorous content. These distinctions will cause different kinds of coke to be produced when the coal is heated, which, in turn, determines to a large extent the nature of the end product in the manufacture of steel and pig iron. The taxpayer's customers require certain kinds of coke, depending upon the type iron or steel they manufacture. The taxpayer does not go so far as to say that only coking coal with the identical chemical and physical characteristics as that used by the taxpayer to manufacture coke suitable for its own needs is a "mineral product of like kind and grade". The taxpayer does say that the comparison must be with a coking coal that has the same capacities for profitable use; that only coking coals "interchangeable" with appellant's coking coals are of like kind and grade. None of the coking coals sold in 1952 by other companies were suitable to the taxpayer for its use in the manufacture of coke. The taxpayer argues therefore that none of the coking coal sold was of a "like kind and grade" to the taxpayer's.

The common practice in the industry to avoid effects of different physical and chemical characteristics among coking coals is to blend several types of the coal.[6] Blends are constantly adjusted to compensate for the differences so that in effect the only distinction with any commercial substance is whether the coal is of coking or non-coking

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chemical proximate analysis of a coking coal reflects the amounts of fixed carbon, volatile matter, sulphur and ash contained in a coking coal. Coking coals differ substantially in the amount of carbon which the foundry coke made there from imparts to the material heated by such foundry coke, such characteristic being referred to as the carbon pickup quality of the coking coal. Coking coals also vary with respect to the physical structure of the coke made therefrom, the strength of a particular coke varying with the size of the air cells and thickness of the walls of the air cells in a piece of coke." Appellant's brief.

[6] Coal for furnace cokes need not necessarily be blended, but coal for foundry cokes usually must be blended.

quality.[7] Alabama By-Products does not, however, blend its coals.

The taxpayer argues that since other coking coals can not meet taxpayer's uses, they are not of like kind and grade.[8] The "end use" test has been rejected by the courts even where it has been specifically mentioned in the tax regulations, and advocated by the Government in arguing some of the cases.[9] *Iowa Limestone Co. v. CIR*, 1957, 28 T. C. 881; *Spencer Quarries, Inc., v. CIR*, 27 T. C. 392; *Virginia Limestone Corp. v. CIR*, 1956, 26 T. C. 533. In the Spencer Quarries case the issue was whether quartzite used as a refractory material should receive different depletion treatment than quartzite used for other commercial purposes. The Tax Court held that quartzite is quart-

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[7] But no blends of coal which did not include the Mary Lee coals produced in the Praco area could result in a sufficiently low carbon pickup in the metal being melted by appellant's coke customers to produce a coke for a malleable iron foundry

[8] "The court found that Pratt and American seam coals are not suitable for use by taxpayer in making its foundry coke and Brookwood-Milldale seam coals will not make a foundry coke to conform to taxpayer's specifications. Blue Creek seam coal mined from the Black Diamond Mining Company's Johns and Adger mines differs from taxpayer's Mary Lee coals, in that the latter has a lower carbon pickup; the Underwood seam coal differs from taxpayer's Black Creek seam coal in that the volatile ash and sulphur content of the former was higher and the coking properties lower and such coal was undesirable for taxpayer's foundry coke. However, Blue Creek, Brookwood, Pratt, Thompson, Woodstock, Bynum and Black Creek seam coals were consistently and extensively sold, as coking coal, in the Birmingham districts in the years 1951-1955."

[9] See Rev. Rul. 56-59, 1956-1, C. B. 626; G. C. M. 24185, 1944, C. B. 132; Treas. Regs. 118, Section 39.23 (m)-5 (b). The "end use" test would not be applicable here even if accepted by the courts. By the very terms of the statutes and regulations mentioning this test, it applied only to clay, brick and tile, limestone, and calcium carbonates that are used for a stated purpose. Such minerals are entitled to percentage depletion only if used for the stated purpose, whereas, percentage depletion applies to all coal regardless of its issue. Thus, end use has no bearing on "like kind and grade." See Treas. Regs. 118, Section 39.23 (m)-5 (b).

zite, and the particular use for which it is suitable will not make it another kind of material; therefore, uniform treatment was given. Section 39.23 (m)-5 (b) of Treasury Regulations 118 does make percentage depletion applicable to certain minerals, "used or sold for use" for a stated purpose. Here, in another part of the Regulations, however, the Treasury Department has merely used the phrase "Mineral product of like kind and grade". We cannot assume that it was intended that the use to which the property was actually put should be decisive in classifying mineral products for purposes of the representative market price and proportionate profits methods of computing the gross income from mining."

Counsel have cited no cases on brief that interpret the crucial phrase. We have been unable to find any.

This Court has been called upon more than once to interpret the phrase "like kind" as it is used elsewhere in the 1939 Code. We have consistently held that "like kind" is a broad phrase contemplating the distinction between classes of property (for example, personal and real) no matter how dissimilar they may be in location, in attributes, and in capacities for profitable use. *Fleming v. CIR*, 5 Cir., 1957, 241 F. 2d 78; *Fleming v. Campbell*, 5 Cir., 1953, 205 F. 2d 549; *CIR v. Crichton*, 5 Cir., 1941, 122 F. 2d 181. The District Court held, and we agree, that all bituminous coals are of like kind, or of the same general property classification.

The phrase "like grade", as it is used here, has not been interpreted. There is no indication that a narrow interpretation of this phrase was intended. Section 39.23 (m)-7 of the Regulations indicates that a liberal interpretation was contemplated:

"(a) If the fair market value of the property at a specified date is to be determined for the purpose of

> ascertaining the basis for depletion and depreciation deductions, . . . [t]he value sought should be that established assuming a transfer between a willing seller and a willing buyer as of that particular date. The Commissioner will give due weight and consideration to any and all factors and evidence having a bearing on the market value, such as cost, actual sales and transfers of *similar* properties, . . .

It is not unlikely that the term "similar properties" contemplates a "mineral product of like kind and grade."[10]

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[10] There is dictum in CIR v. Crichton, 5 Cir., 1941, 122 F. 2d 181, that might indicate that the refined distinctions such as taxpayer argues should be recognized, and that the phrase "mineral product of like kind and grade" should be narrowly construed. The court said that "like kind" is general, and does not contemplate "dissimilarities in grade or quality, the unlikeliness in attributes, appearance, and *capacities*." Taxpayer would construe this as an interpretation of "like grade." This is tenuous because the phrase "like grade" was in no way involved in this case, nor was it ever mentioned.

The proposed regulations to section 613 of the 1954 Code strengthen our view of that "like kind and grade" contemplates similar properties. The regulations provide in part:

> "(4) . . . For the purposes of this paragraph the term 'market price' means the price . . . at which the gross income product is sold commercially . . . If there are no such commercial sales in such area, then the market price of the gross income product must be determined by the use of other appropriate methods with the objective of determining as accurately as practicable the price at which such gross income product would be sold if such commercial sales existed."

One such appropriate method is:

> "(i). Comparison with the prices at which crude mineral products *similar to the taxpayer's* gross income product are sold commercially in the vicinity of the taxpayer's mine with proper adjustment being made for material differences, if any, between taxpayer's gross income product and the products sold commercially (such as differences in kind or grade *or mineral content* or ordinary treatment processes involved or transportation costs between mine and market or relative volume of sales). Proposed Regulations, Section 1.613-3, P-H, Internal Revenue Code, p. 24,618.10.

Thus, mineral content is distinguished from kind and grade in the proposed regulations.

The District Court concluded that all bituminous coals in the Alabama fields are of like grade if commercially suitable for use in the manufacture of coke generally, regardless of the taxpayer's particular needs. To go further and classify coking coals according to their myriad of actual uses would lead to an unworkable system of grading coal, since the requirements of coke users vary greatly. There would never be, in the case of coking coal, a "mineral product of like kind and grade"; we would have a phrase without meaning.

The sales and purchases of coking coal by DeBardeleben, Republic, United States Steel, United States Pipe and Foundry and others were extensive enough to establish a representative market price. Although the sales made by the taxpayer were in the nature of "forced" sales owing to peculiar economic conditions,[11] the sales of coking coal by the other companies were the natural result of competitive bargaining, and principles of supply and demand. This is enough to create a true market in commerce.[12] *Helver-*

[11] The record shows that since World War I the coal industry has been declining and uncertain. As a result, plants operated on a three day work week and employees were dissatisfied. To remedy this, and to spread overhead costs, taxpayer made sales at prices less than its cost of production. Such sales were not made in open and free competition.

[12] Riverton Lime and Stone Co. v. CIR, 1957, 26 T. C. No. 49, indicates that even a small, declining market can establish a representative market or field price. The Tax Court held that although there were only small sales of pure lime, the price received was the representative market or field price. The proportionate profits method was not allowed because it allocated too large a percentage of the total profit realized by the taxpayer to processes used for producing a better product. The fact remains, however, that the court allowed a sales price in a restricted number of sales to stand as the representative market or field price.

The taxpayer argues that the Riverton case is erroneous and relies strongly on United States v. Cherokee Brick & Tile Co., 5 Cir., 1955, 218 F. 2d 424. In that case the taxpayer mined clay which it used to make bufut brick. "Gross income from mining" includes income realized from the first commercially marketable

ing v. Walbridge, 2 Cir., 1934, 70 F. 2d 683; *Heiner v. Crosby*, 3 Cir., 1928, 24 F. 2d 191. What Judge Learned Hand had to say in the Walbridge case is applicable here:

> "Perhaps there need not be a 'market' to establish a 'market value,' but there must be some assurance that the value is what a 'market' would establish; and a 'market' itself presupposes enough competition between buyers and sellers to prevent the exigencies of an individual from being exploited. It may well imply that the goods have several possible buyers, so that a necessitous seller shall not be confined to one, and that there are several possible sellers of the same goods or their *substantial* equivalent, so that a hard-pressed buyer shall not have to accept the first offer."

There is no contention that the coking coal sold by other companies and agencies is identical with the taxpayer's, but, on the record, for practical purposes, it was of "like kind and grade," a "substantial equivalent" sold and purchased in free competition.

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mineral product obtained from ordinary treatment processes. The Government contended that the first commercially marketable mineral product was the clay itself, and that in computing gross income, that which the taxpayer realized from its sales of clay should be included. The court rejected this contention, stating:

> "The complaint alleges that, of the brick and tile clay mined in the United States, there is opportunity for the sale of only a negligible quantity before it is put into the form of burnt brick and tile. This allegation is admitted in the answer of the [Government]. For this and other reasons (but mainly for this one) stated in the opinion of the district court, above cited, the judgment appealed from should be affirmed."

The Cherokee Brick & Tile case is not applicable. The question of whether there was a representative market price for clay at the stage of processing prior to the manufacturing of the finished brick was not involved; the issues were limited to whether the processes applied were ordinary treatment processes, and whether the finished product was a mineral product. Mertens, Law of Federal Income Taxation, Section 24.32b, n. 76. The issue here is whether there exists a representative market price for a mineral product of like kind and grade to coking coal mined by the taxpayer. Cherokee Brick & Tile does not help to answer this.

The proportionate profits method provided by the Regulations was not intended to assure percentage depletion to a taxpayer who conducts his mining operations at a loss. It is designed to operate only with respect to gross income, subject to the 50 per cent limitation, and only when there is no representative market or field price at the ordinary treatment processing stage. If there is such a price at which the taxpayer could sell, but it happens that the taxpayer, as here, operates that phase of the business at a loss, then the 50 per cent net income limitation precludes the allowance. The taxpayer's remedy lies with Congress.

Summarizing, we have a situation here that calls for some workable definition of the phrase "mineral product of like kind and grade". Of course there are differences in coal. Here, it seems to us, as in practical matter, the differences are meaningless if a coal meets the standard of coking quality. In effect, this is the standard used commercially in the area. The Commissioner would have a difficult, if not impossible, task, if he had to determine whether one coal was "interchangeable" with another coal; there are so many variables in the composition of coal, that even all coal from the same seam is not necessarily interchangeable. We agree, therefore, with the district court that "like kind and grade" means as to "kind", all bituminous coals mined in the Birmingham area, and, as to "grade", means all coals having coking quality suitable for commercial use. Since the taxpayer's coals are of like kind and grade to other coking coals that were sold in the area, the taxpayer has failed to meet its burden of proving that there was no representative market or field price for its coals.

III.

We affirm also the dismissal of the amended claims for refund. All grounds upon which a taxpayer relies must

be stated in the original claim for refund so as to apprise the Commissioner of what to look into; the Commissioner can take the claim at its face value and examine only those points to which his attention is necessarily directed. *United States v. Garbutt Oil Co.*, 1938, 302 U. S. 528, 58 S. Ct. 320, 82 L. Ed. 405. Anything not raised at that time cannot be raised later in a suit for refund. *Carmack v. Scofield*, 5 Cir., 1953, 201 F. 2d 360. The taxpayer's claim for refund was based solely on the ground that there was no representative market price. There was no attempt to raise the question of the correctness of an existing representative price. In fact, the claim for refund precluded this question. There was likewise no attempt to raise the question of any improper allocation of overhead and other expenses.

What we said in the Carmack case applies with equal vigor here:

> "A taxpayer is not permitted to advance on ground for refund in his claim filed with the Commissioner and thereafter rely upon an entirely different ground in a subsequent suit for refund, *but is confined to the scope of the grounds for refund asserted in his claim filed with the Commissioner.*"

The judgment is

(Seal) Affirmed.

A true copy

Test: Edward W. Wadsworth,
Clerk, U. S. Court of Appeals, Fifth Circuit,
By Gilbert F. Ganucheau,
Deputy.

New Orleans, Louisiana.

Judgment.

Extract from the Minutes of August 29, 1958.

Alabama By-Products Corporation

No. 16,840 versus

George D. Patterson, District Director of Internal Revenue.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Alabama, and was argued by counsel;

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed.

INTERNAL REVENUE CODE OF 1939.*

Sec. 23. *Deductions From Gross Income.*

In computing net income there shall be allowed as deductions:

* * * * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and

* Emphasis supplied throughout.

lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

For percentage depletion allowable under this subsection, see section 114 (b), (3) and (4).

(53 Stat. 1, 26 U. S. C. 1952 ed., Sec. 23.)

Sec. 114. *Basis for Depreciation and Depletion.*

* * * * * * * *

(b) *Basis for Depletion.*—

* * * * * * * *

(4) *Percentage depletion for coal and metal mines and for certain other mines and natural mineral deposits.*—

(A) In general.—The allowance for depletion under section 23 (m) in the case of the following mines and other natural deposits shall be—

(i) in the case of sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, shale, oyster shell, clam shell, granite, marble, sodium chloride, and, if from brine wells, calcium chloride, magnesium chloride, and bromine, 5 per centum.

(ii) in the case of coal, asbestos, brucite, dolomite, magnesite, perlite, wollastonite, calcium carbonates, and magnesium carbonates, 10 per centum.

(iii) in the case of metel mines, aplite, bauxite, fluorspar, flake graphite, vermiculite, beryl, garnet,

feldspar, mica, talc (including pyrophyllite), lepidolite, spodumene, barite, ball clay, sagger clay, china clay, phosphate rock, rock asphalt, trona, bentonite, gilsonite, thenardite, borax, fuller's earth, tripoli, refractory and fire clay, quartzite, diatomaceous earth, metallurgical grade limestone, chemical grade limestone and potash, 15 per centum, and

(iv) in the case of sulfur, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the **net income of the taxpayer (computed without allowance for depletion) from the property**, except that in no case shall the depletion allowance under section 23 (m) be less than it would be if computed without reference to this paragraph.

(B) Definition of gross income from property.—As used in this paragraph the term "gross income from the property" means the **gross income from mining**. The term "mining" as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills. The term "ordinary treatment processes," as used herein, shall include the following: (i) in the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cool-

ing, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 450 and 453.

(53 Stat. 1, as amended by 53 Stat. 45, 56 Stat. 840, 58 Stat. 44, 45, 61 Stat. 920, 64 Stat. 931, 64 Stat. 1220, 65 Stat. 497; 26 U. S. C. 1952 ed., Sec. 114.)

United States Treasury Regulations 118 promulgated under the Internal Revenue Code of 1939:

§ 39.23 (m)-1 *Depletion of mines, oil and gas wells, other natural deposits and timber; depreciation of improvements.*

* * * * * * * *

(e) As used in sections 114 (b) (3) and 114 (b) (4) (A) and §§ 39.23 (m)-1 to 39.23 (m)-19, inclusive, the term "gross income from the property" means the following:

(1) In the case of oil and gas wells, "gross income from the property," as used in section 114 (b) (3), means the amount for which the taxpayer sells the oil and gas in the

immediate vicinity of the well. If the oil and gas are not sold on the property but are manufactured or converted into a refined product prior to sale, or are transported from the property prior to sale, the gross income from the property shall be assumed to be equivalent to the representative market or field price (as of the date of sale) of the oil and gas before conversion or transportation.

(2) In the case of a crude mineral product other than oil and gas, "gross income from the property," as used in section 114 (b) (4) (A), means the gross income from mining. The term "mining" as used herein includes not only the extraction of ores or minerals from the ground but also the ordinary treatment processes which are normally applied by the mine owners or operators to the crude mineral product after extraction in order to obtain the commercially marketable mineral product or products. The term "mining" as used herein also includes so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles, and, if the Commissioner finds that both the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills, the transportation over such greater distance. The taxpayer shall file an original and one copy of an application for the inclusion of such greater distance in the computation of his gross income from mining with the Commissioner of Internal Revenue, Washington 25, D. C., attention of the Special Technical Services Division, Engineering and Valuation Branch. The application must include a statement setting forth in detail such facts concerning the physical and other requirements for the construction and operation of a treatment plant at a place nearer to the point of extraction from the ground as are sufficient to apprise the Commissioner of the exact basis of the applica-

If the taxpayer's return is filed prior to receipt of
of the Commissioner's action upon the application,
y of such application shall be attached to the return.
er an application is approved by the Commissioner,
is a material change in any of the facts relied upon
h application, a new application must be submitted
taxpayer.

If the taxpayer sells the crude mineral product of
perty in the immediate vicinity of the mine, "gross
from the property" means the amount for which
oduct was sold, but, if the product is transported or
ed (other than by the ordinary treatment processes
ed below) before sale, "gross income from the prop-
means the representative market or field price (as
date of sale) of a mineral product of like kind and
is beneficiated by the ordinary treatment processes
applied, before transportation of such product
han transportation treated, for the taxable year, as
. If there is no such representative market or field
s of the date of sale), then there shall be used in
eof the representative market or field price of the
ketable product resulting from any process or
(or, if the product in its crude mineral state is
nsported, the price for which sold) minus the
roportionate profits attributable to the trans-
other than transportation treated, for the tax-
as mining) and the processes beyond the ordi-
ment processes. If the taxpayer establishes to the
n of the Commissioner that another method of
on, other than the computation of profits propor-
costs, clearly reflects the gross income from the
then such gross income shall be computed by the
other method.

letermining "gross income from the property,"
rice of the product shall not be reduced by the
roportionate profits attributable to the trans-

portation which is treated for such taxable year as mining, that is, so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles (or, if the Commissioner finds that both the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills, such greater distance). Where such plants or mills are in excess of 50 miles (or of such greater distance) from the point of extraction from the ground, then costs incurred for transportation in excess of 50 miles (or of such greater distance) to the treatment plant and, if transported by the taxpayer, the proportionate profits attributable to such excess transportation should be subtracted from the sale price of the product to determine "gross income from the property." In the absence of methods which will clearly reflect costs of the various phases of transportation, the costs attributable to such excess transportation shall be an amount which is in the same ratio to the costs incurred for the total transportation to the treatment plant as the excess transportation is to such total transportation. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation other than the computation of profits proportionate to cost clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method.

(5) In all cases there shall be excluded in determining the "gross income from the property" an amount equal to any rents or royalties which were paid or incurred by the taxpayer in respect of the property and are not otherwise excluded from the "gross income from the property." If royalties in the form of bonus payments have been paid in respect of the property in the taxable year or any prior years, or if advanced royalties have been paid in respect

of the property in any taxable year ending prior to December 31, 1939, the amount excluded from "gross income from the property" for the current taxable year on account of such payments shall be an amount equal to that part of such payments which is allocable to the product sold during the current taxable year. If advanced royalties have been paid in respect of the property in any taxable year ending on or after December 31, 1939, the amount excluded from "gross income from the property" for the current taxable year on account of such payments shall be an amount equal to the deduction for such taxable year taken on account of such payments pursuant to § 39.23 (m)-10 (e).

(6) Rents and royalties paid or incurred by a taxpayer with respect to coal shall be excluded from the "gross income from the property" without regard to the treatment under section 117 (k) (2) of such rents and royalties in the hands of the recipient.

(f) (1) The term "ordinary treatment processes," as used in §§ 39.23 (m)-1 to 39.23 (m)-19, inclusive, shall include the following:

(i) In the case of coal—cleaning, breaking, sizing, and loading for shipment;

(ii) In the case of sulfur—pumping to vats, cooling, breaking, and loading for shipment;

(iii) In the case of iron ore, bauxite, bail and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering (agglomerating by incipient fusion) to bring to shipping grade and form, and loading for shipment;

(iv) In the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and minerals which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration

(gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation, or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the mineral. The furnacing of quicksilver ores is included in the term "ordinary treatment processes." The following processes are not included in the term "ordinary treatment processes": electrolytic deposition, roasting, thermal or electric smelting, refining, or substantially equivalent processes.

(2) In addition, a treatment effecting a chemical change, the blending with other material, a thermal action, and the fine pulverization, pressing into shape or molding, are not included in the term "ordinary treatment processes" unless such processes are (.) otherwise provided for in subdivisions (i), (ii), (iii), or (iv) of subparagraph (1); (ii) necessary or incidental to the processes provided for in subdivisions (i), (ii), (iii), or (iv) of subparagraph (1); or (iii) necessary to bring the ores or minerals into condition or form suitable for shipment (for example, the agglomeration of concentrates).

(3) For the purposes of subdivisions (iii) and (iv) of subparagraph (1), the terms "concentration" or "concentrating" mean the process of eliminating waste or of separating two or more minerals or ores.

(g) "Net income of the taxpayer (computed without allowance for depletion) from the property," as used in section 114 (b) (2), (3) and (4) and §§ 39.23 (m)-1 to 39.23 (m)-19, inclusive, means the "gross income from the property," as defined in paragraph (e) of this section, less the allowable deductions attributable to the mineral property upon which the depletion is claimed and the allowable deductions attributable to the processes listed in paragraph (f) of this section in so far as they relate to the product of such property, including overhead and operat-

ing expenses, development costs properly charged to expense or allowable as deductions under section 23 (cc), depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. Deductions not directly attributable to particular properties or processes shall be fairly allocated. To illustrate: In cases where the taxpayer engages in activities in addition to mineral extraction and to the processes listed in paragraph (f) of this section, deductions for depreciation, taxes, general expenses, and overhead, which cannot be directly attributed to any specific activity, shall be fairly apportioned between (1) the mineral extraction and the processes listed in paragraph (f) of this section and (2) the additional activities, taking into account the ratio which the operating expenses directly attributable to the mineral extraction and the processes listed in paragraph (f) of this section bear to the operating expenses directly attributable to the additional activities. If more than one mineral property is involved, the deductions apportioned to the mineral extraction and the processes listed in paragraph (f) of this section shall, in turn, be fairly apportioned to the several properties, taking into account their relative production.

(h) As used in paragraphs (e) and (f) of this section, the term "crude mineral product" means the product in the form in which it emerges from the mine or well.

(i) "The property," as used in section 114 (b) (2), (3), and (4) and §§ 39.23 (m)-1 to 39.23 (m)-19, inclusive, means the interest owned by the taxpayer in any mineral property. The taxpayer's interest in each separate mineral property is a separate "property"; but, where two or more mineral properties are included in a single tract or parcel of land, the taxpayer's interest in such mineral properties may be considered to be a single "property," provided such treatment is consistently followed.

As amended T. D. 6059, 19 F. R. 249, Jan. 14, 1954; T. D. 6096, 19 F. R. 5479, Aug. 27, 1954.